

## Message Text

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INFO OCT-01 EA-11 ISO-00 NEA-11 AGR-20 CEA-02 CIAE-00

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LAB-06 NSAE-00 NSC-10 PA-04 RSC-01 AID-20 CIEP-02

SS-20 STR-08 TAR-02 TRSE-00 USIA-15 PRS-01 SPC-03

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OC-06 CCO-00 DRC-01 IO-14 /241 W  
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R 071527Z FEB 74

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 7786

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652:N/A

TAGS: EFIN, UK

SUBJECT: IMPACT OF ENERGY SITUATION ON 1974 DOMESTIC  
ECONOMIC PROSPECTS; T/IEP, FOREIGN MINISTERS' MEETING ON  
INTERNATIONAL ENERGY PROBLEMS; WEEKLY UPDATE

REF: (1) LONDON 1268; (2) LONDON 1658; (3) LONDON 1667

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BEGIN SUMMARY: THE ALMOST CERTAIN COAL MINERS STRIKE BE-

GINNING SUNDAY, FEBRUARY 10, APPRECIABLY WORSENS THE OUT-LOOK FOR THE BRITISH ECONOMY IN 1974. THE IMPACT OF THE STRIKE IS IMPOSSIBLE TO QUANTIFY "EX ANTE"

BUT ECONOMIC PUNDITS, GOVERNMENT OFFICIALS, INDUSTRY SPOKESMEN, ECONOMIC INSTITUTE STAFF MEMBERS ARE ALL UNANIMOUS IN DESCRIBING THE CONSEQUENCES OF A STRIKE AS GRAVE. THE REAL QUESTIONS ARE HOW LONG IT WILL GO ON, HOW MUCH ITS LENGTH WILL IMPAIR RECOVERY WHEN IT IS OVER, WHAT THE INFLATIONARY CONSEQUENCES OF THE STRIKE AND ITS INEVITABLE SETTLEMENT WILL BE, AND THE DAMAGE IT WILL INFLICT ON THE ALREADY HEAVY DEFICIT OF THE UK CURRENT ACCOUNT. END SUMMARY

1. THERE IS NO WAY YET TO ESTIMATE THE IMPACT OF THE MINERS STRIKE, BEGINNING NEXT WEEK, ON THE BRITISH ECONOMY. ONE CRUCIAL VARIABLE IS THE LENGTH OF THE STRIKE. OUR ASSESSMENT REMAINS PRETTY MUCH AS REPORTED IN REF 1. COAL STOCKS AT POWER STATIONS ARE AT HIGH LEVELS FOR THIS TIME OF THE YEAR DUE MAINLY TO THE WARM WINTER, THE SAVINGS IN ELECTRICITY BY THE LIMITATIONS ON POWER USE BY INDUSTRY, AND TO INCREASED DELIVERIES OF OIL TO THE POWER STATIONS. AT PRESENT RATES OF CONSUMPTION, THERE ARE ABOUT FIVE WEEKS OF COAL SUPPLIES AVAILABLE BEFORE STOCKS AT POWER STATIONS REACH A DANGER LEVEL. THUS, THE POWER SITUATION COULD REMAIN AS AT PRESENT UNTIL LATE MARCH. WE WOULD ASSUME, HOWEVER (THERE HAS BEEN NO GOVERNMENT POLICY ANNOUNCED YET), THAT THE GOVERNMENT WILL TAKE MEASURES TO REDUCE ELECTRICITY CONSUMPTION FURTHER SOON AFTER THE STRIKE BEGINS AND THAT THESE MEASURES WILL MAINLY FALL, AT LEAST INITIALLY, ON THE PRIVATE HOUSEHOLD SECTOR. THIS COULD BE DONE THROUGH SELECTIVE POWER CUTS.

2. THUS, POWER SUPPLIES TO INDUSTRY MAY CONTINUE AT THE PRESENT LEVEL INTO MID-MARCH. HOWEVER, THE COAL STRIKE WILL SEVERELY IMPACT ON STEEL PRODUCTION (50 PERCENT OUTPUT AFTER 3 WEEKS--30 PERCENT AFTER 7 WEEKS) AND THIS WILL INEVITABLY LEAD TO FURTHER PRODUCTION CUTBACKS BY MANY INDUSTRIES. THERE ARE ALREADY GROWING REPORTS OF GENERAL INDUSTRIAL PRODUCTION CUTBACKS LARGELY BECAUSE OF A LACK OF MATERIAL (MAINLY STEEL) AND COMPONENT INPUTS. THE UNCLASSIFIED

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MONTHLY FINANCIAL TIMES BUSINESS SURVEY SHOWS OUTPUT DOWN 20 PERCENT IN ELECTRICAL ENGINEERING INDUSTRIES AND 30 PERCENT IN CONSUMER DURABLES INDUSTRIES. THE MAIN REASON CITED IN THE SURVEY WAS MATERIALS AND COMPONENTS SHORT-AGES. (THE SURVEY ALSO REPORTS BUSINESS CONFIDENCE AT AN ALL TIME LOW AND CONSUMER CONFIDENCE DROPPING, INVESTMENT DECISIONS BY INDUSTRY BEING HELD UP, AND GROWING BUSINESS EXPECTATIONS OF RISING COSTS AND SEVERELY RESTRICTED

PROFITS.)

3. REPORTS GROW OF FINANCIAL DIFFICULTIES BY SMALLER COMPANIES AS OUTPUT IS CUT BACK AND CREDIT LINES TIGHTEN. BY EXACERBATING OUTPUT REDUCTIONS THE STRIKE WILL, OF COURSE, ACCELERATE THE RATE AT WHICH COMPANIES BEGIN TO EXPERIENCE CASH FLOW AND CREDIT PROBLEMS.

4. THE MAJOR QUESTION IS HOW LONG THE STRIKE WILL LAST (SEE REF 3 FOR POLITICAL ASSESSMENT). IT IS DIFFICULT TO SEE IT ENDING QUICKLY. AS IT GOES ON, ITS EFFECT, INCLUDING ON POST-STRIKE RECOVERY PROSPECTS, WILL BE INCREASINGLY SEVERE. AS COMPANIES EXPERIENCE INCREASING LIQUIDITY PROBLEMS AND CONTINUE TO RUN DOWN STOCKS, THE

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R 071527Z FEB 74

FM AMEMBASSY LONDON

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INFO AMEMBASSY BONN

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PROSPECTS OF A QUICK ECONOMIC RECOVERY AFTER THE SETTLEMENT APPEAR MORE REMOTE. THUS, ALLOWANCE MUST BE MADE TO REVISE DOWNWARD THE PRE-STRIKE ASSESSMENT OF THE ENERGY IMPACT ON THE BRITISH OUTPUT (ZERO TO MINUS 3 PERCENT GROWTH ON AN ANNUAL BASIS - LONDON 949). HOW FAR DOWNWARD IS DEPENDENT ON THE LENGTH OF THE STRIKE.

5. A UK TREASURY FORECAST EXERCISE INCLUDING STRIKE ASSUMPTIONS IS NOT YET COMPLETE ACCORDING TO OUR CONTACTS.  
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HOWEVER, A PRELIMINARY ROUGH ESTIMATE BY A STAFF MEMBER IS THAT FIRST QUARTER OUTPUT MAY FALL BY 20-25 PERCENT AS A RESULT OF THE STRIKE. THIS EVIDENTLY IS BASED ON THE ASSUMPTION OF A FOUR-WEEK STRIKE. TREASURY STAFF ALSO ECHOES OUR POINT THAT LENGTH OF STRIKE PRIMARY DETERMINANT IN RAPIDITY OF RECOVERY AFTER STRIKE ENDS.

6. THE ONLY FORECAST SO FAR KNOWN WHICH INCLUDES STRIKE ASSUMPTIONS IS BY NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH (NIESR). (THIS IS A PRELIMINARY FORECAST MEANT ULTIMATELY FOR THEIR QUARTERLY BULLETIN AND GIVEN TO US IN ADVANCE ON A CONFIDENTIAL BASIS - PLEASE DO NOT DIVULGE.) NIESR POSITS FOUR POSSIBLE SITUATIONS ON ENERGY, A PESSIMISTIC OUTLOOK AND AN OPTIMISTIC OUTLOOK FOR BOTH COAL AND OIL. THE ASSUMPTION WHICH SEEMS TO FIT PRESENT REALITY MOST CLOSELY IS THE ONE WHICH IS (A) PESSIMISTIC ON COAL (STRIKE LASTS UNTIL END-MARCH--SEVEN WEEKS, 3-DAY POWER LIMIT ON INDUSTRY CONTINUES UNTIL END-APRIL, 10 PERCENT CUT IN ELECTRICITY CONSUMPTION CONTINUES UNTIL END OF YEAR) AND (B) OPTIMISTIC ON OIL (15 PERCENT CUT IN SUPPLY IN JANUARY AND FEBRUARY, 10 PERCENT CUT IN MARCH AND APRIL, 2.5 PERCENT INCREASE FROM MAY THROUGH DECEMBER--ON SEPTEMBER 1973 LEVELS). ON THIS ASSUMPTION, NIESR HAS POTENTIAL OUTPUT FALLING BY 1/2 PERCENT DURING THE YEAR. IT IS IMPORTANT TO NOTE THAT THIS IS POTENTIAL OUTPUT (I.E. ESTIMATED OUTPUT CAPACITY BASED ON LABOR AND INVESTMENT TRENDS), NOT GDP. NIESR STAFF BELIEVE THAT THE GDP GROWTH FIGURE WILL BE SOMEWHAT LOWER BECAUSE OF THE DEFLATIONARY IMPACT OF THE DEC. 17 MINI-BUDGET, AND THE OIL PRICE INCREASES. (N.B. NIESR NOW CALCULATES THAT BECAUSE OF SHORTFALLS IN PLANNED PUBLIC SPENDING AND BECAUSE ABOUT 15-20 PERCENT OF THE DEC. 17 MINI-BUDGET CUTS WILL

BE IMPOSSIBLE TO MAKE, THE EFFECTIVE AMOUNT OF THE MINI-BUDGET DECREASES IN PUBLIC EXPENDITURE IS ABOUT 780 MILLION POUNDS.) THE NIESR PESSIMISTIC ASSUMPTION ON BOTH COAL AND OIL (OIL SUPPLY 15 PERCENT DOWN IN JANUARY AND FEBRUARY, 22.5 PERCENT DOWN THROUGH REST OF YEAR) HAS POTENTIAL OUTPUT FALLING BY 3.5 PERCENT.

7. NIESR FORECASTS OF THE IMPACT ON PRICES OF THE STRIKE ASSUMPTION NOT YET COMPLETE. IT IS APPARENT, HOWEVER, UNCLASSIFIED

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THAT INFLATION COULD BE EXACERBATED BEYOND THE PRESENTLY EXPECTED 13-15 PERCENT INCREASE IN RETAIL PRICES IF STAGE 3 CONTINUES IN ITS PRESENT FORM. COMPANIES WITH CASH FLOW PROBLEMS WILL PROBABLY WANT TO PASS ON WAGE COST INCREASES REFLECTED IN STAGE 3 AGREEMENTS AND THE ESCALATOR CLAUSE IMMEDIATELY, THUS SHORTENING THE 6-MONTH LAG BETWEEN WAGE INCREASES AND THEIR REFLECTION (BY NEARLY HALF THE AMOUNT) IN RETAIL PRICES. THIS IS VIEWED AS NORMAL BY TREASURY. MOREOVER, THE MINERS SETTLEMENT MAY WELL BE OUTSIDE THE STAGE 3 LIMITS. THERE IS ALWAYS THE CHANCE, OF COURSE, THAT STAGE 3 WILL BE MODIFIED OR A STRICTER STAGE 4 BROUGHT FORWARD FASTER THAN EXPECTED.

8. THE DIRECTOR OF THE NATIONAL ECONOMIC DEVELOPMENT OFFICE (NEDO) STATED YESTERDAY THAT THE UNEMPLOYMENT LEVELS WOULD BE "ASTRONOMICAL" IF A STRIKE OCCURS. A NEDO SURVEY OF INDUSTRY INDICATES THAT UNDER PRESENT CONDITIONS (WITHOUT A STRIKE) UNEMPLOYMENT WILL BE AT ABOUT 4 MILLION BY THE END OF FEBRUARY. THIS INCLUDES THOSE WORKING PART-TIME. THE NEDO SURVEY ALSO INDICATES GENERAL OUTPUT LOSSES OF 20-25 PERCENT AT PRESENT WITH SOME COMPANIES REDUCING OUTPUT BY UP TO 40 PERCENT AS MATERIAL INPUTS BECOME SCARCER AND THE INITIAL CUSHION PROVIDED BY STOCKS (INVENTORIES) DISAPPEARS.

9. THE OTHER MAJOR QUESTION IS WHAT DIRECTION WILL POLICY TAKE IN THE MARCH-APRIL BUDGET. MANY ECONOMIC JOURNALISTS SUCH AS SAMUEL BRITTAN AND ANTHONY HARRIS AS WELL AS THE CAMBRIDGE ECONOMIC POLICY GROUP HAVE ARGUED IN FAVOR OF A NEUTRAL BUDGET, SAYING THAT EVEN WITH SUPPLY CONSTRAINTS OF A 3-DAY POWER LIMIT, THE IMPACT OF THE MINI-BUDGET AND THE OIL PRICE RISES ARE SUFFICIENTLY DEFLATIONARY TO PREVENT EXCESS DEMAND FROM DEVELOPING WITH ITS IMPLICATIONS

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FM AMEMBASSY LONDON

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FOR WORSENING THE INFLATION AND BALANCE OF PAYMENTS  
PROSPECTS. THEY FEEL THAT FURTHER DEFLATION IS DANGEROUS  
FROM AN INTERNATIONAL POINT OF VIEW (COMPETITIVE  
DEFLATIONS) AS WELL AS FROM THE PURELY DOMESTIC POINT OF  
VIEW.

10. IN A SPEECH ON MONDAY, FEBRUARY 4, CHANCELLOR OF THE  
EXCHEQUER BARBER REFUSED TO PREVIEW THE BUDGET, BUT DID  
STATE THAT THE BRITISH PEOPLE ARE READY TO BEAR THE  
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SUFFERING REQUIRED TO RESTORE THE DOMESTIC ECONOMY TO HEALTH. IN COMMONS ON DECEMBER 6, BARBER STATED HE COULD NOT RULE OUT TAX INCREASES. THERE IS A RAPIDLY GROWING EXPECTATION THAT THERE WILL BE A GENERAL ELECTION SOON; THE CHANCELLOR WILL BE FORCED TO BE MORE SPECIFIC ON HIS POLICY AIMS IF THE ELECTION DOES OCCUR.

11. BARBER ALSO WARNED OF THE EFFECT ON UK TRADE OF THE SHORT WORK WEEK. THE STRIKE WILL MAKE THE IMPACT ON UK TRADE MORE SEVERE, CUTTING EXPORT PRODUCTION, HURTING EXPORT ORDERS, AND CREATING A DEMAND FOR IMPORTS OF MATERIALS AND COMPONENTS AS WELL AS CONSUMER GOODS. HEAVY RESERVE LOSSES (DOWN \$298 MILLION IN JANUARY) EXPECTED TO CONTINUE, ALTHOUGH BEING OFFSET IN TOTAL OR IN PART BY PUBLIC SECTOR BORROWING.

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## Message Attributes

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